No. 15,299

United States Court of Appeals

For the Ninth Circuit

WALTER J. HEMPY, as Trustee of the Estate of Mechanix, Inc., a corporation, bankrupt,
Appellant,

vs.

JOHN HOWARD SIMS and MARVIN D. MORROW,
Appellees.

APPELLEES' REPLY BRIEF.

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STATEMENT OF JURISDICTION.

Appellant herein filed a complaint in the District Court (Tr. p. 4) to recover a preference from appellees pursuant to the provisions of section 60(b), 11 U.S.C.A. 96(b) of the Bankruptcy Act. The District Court rendered its judgment in favor of appellees. Pursuant to the provisions of 11 U.S.C.A. 47, appellant filed his notice of appeal on July 5, 1956. (Tr. p. 13.) The appeal was timely filed. (11 U.S.C.A. 48.)

STATEMENT OF THE QUESTION PRESENTED.

In addition to questions presented by appellant in its opening brief, this Court shall be called upon to

determine whether or not appellees gave appellant's predecessor, the bankrupt corporation, a present consideration for the payment of past due salaries to the appellees.

STATEMENT OF FACTS.

In addition to the facts set forth in appellant's statement of facts certain other facts are essential to the consideration of the questions presented on this appeal.

On the eighth day of March, 1953, Mechanix, Inc., a corporation which employed the appellees, made payment to the appellees of salaries which were due for the period from January 4, 1953 to March 8, 1953. (Tr. p. 25.) At that time the soon to be adjudicated bankrupt had received a substantial payment from one of its debtors and the money received from the said debtor enabled the bankrupt to pay the salaries which were then due. It was the intention of the appellees who were the sales manager and plant superintendent of Mechanix, Inc., to leave the employ of Mechanix, Inc., unless the salaries that were due to them were paid. (Tr. pp. 60-61.) On March 8, 1953 Mechanix, Inc., a corporation had claims pending against various agencies of the United States government for sums in excess of $150,000.00 for services rendered in repairing ships belonging to the various agencies of the United States government. (Tr. pp. 27, 52.)

ARGUMENT.

1. THE DISTRICT COURT DID NOT COMMIT ERROR IN FINDING THAT APPELLEES PROMISED TO CONTINUE IN THE EMPLOYMENT OF MECHANIX, INC., AT THE TIME THEY WERE PAID THE BACK SALARY.

The District Court made the finding of fact headed number two (Tr. p. 8) as set forth in appellant's opening brief. The only question that the appellate Court has to consider is whether or not there is sufficient evidence in the record to sustain the finding of fact made by the trier of the facts. It is not the duty nor the province of the Circuit Court to review the evidence and determine whether or not the Circuit Court would have decided the case differently if it were to try the facts.

The Appellate Court cannot upset the findings of fact made by the trier of the facts where the evidence is conflicting and where different inferences might be drawn.

Roche v. New Hampshire Nat. Bank, 192 F.2d 203.

It has been held that findings of fact cannot be set aside unless findings are clearly erroneous.

Norberg v. Ryan, C.A. 9th 1951, 193 F.2d 407.

See also:

28 U.S.C.A. Rule 52(a) Federal Rules of Civil Procedure.

The record clearly shows that at least one of the considerations for the payment of the salaries admittedly due to appellees was the promise of appellees

to remain in the employ of the appellant's predecessor (Tr. pp. 60, 61), and therefore it cannot be said that there is no evidence that appellees did not tender a present consideration to appellant or its predecessor for the payment made by the corporation to appellees.

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2. THE DISTRICT COURT DID NOT COMMIT ERROR IN FINDING THAT APPELLEES DID NOT KNOW NOR HAVE REASONABLE CAUSE TO BELIEVE THAT MECHANIX, INC., WAS INSOLVENT AND IN CONCLUDING THEREUPON THAT THE PAYMENT BY MECHANIX, INC., of $1,500.00 EACH TO APPELLEES WITHIN FOUR MONTHS FOR BALANCE OF PAST DUE SALARY WAS NOT A PREFERENTIAL PAYMENT BY SAID MECHANIX, INC.

The Court made the following findings of fact (Tr. p. 8): "(4) That at the time the said defendants received the said payments the defendants did not know, nor did the said defendants have reasonable cause to believe that the said Mechanix, Inc., was insolvent", and the Court drew a conclusion therefrom that the said payment to the appellees by Mechanix, Inc., was not a preferential payment.

The Appellate Court does not have the power to review the evidence and make findings of fact contrary to those found by the trier of the fact where there is a conflict in the evidence. So long as there is sufficient evidence in the record to sustain the findings of fact by the trial Court or by the jury as the case may be, the Appellate Court is bound by the finding so made.

See:

Roche v. New Hampshire Nat. Bank, supra;
Norberg v. Ryan, supra;
28 U.S.C.A. Rule 52(a) Federal Rules of Civil Procedure.

There is ample evidence in the transcript to show that the bankrupt was not insolvent at the time appellees herein received the payment made for salaries previously earned by appellees. (Tr. pp. 26, 27, 51.)

Furthermore, the record discloses that the Court was justified by the evidence in finding that the appellees did not have reasonable cause to believe the bankrupt to be insolvent at the time the appellees received the salaries which were paid to them.

Insolvency has been defined to mean that the fair value of the assets of a business do not exceed the liabilities thereof. The evidence introduced in this case shows that the appellees had reasonable cause to believe that the assets of this corporation did in fact exceed the liabilities. The testimony showed that the corporation throughout all of its business activities had to rely upon payments from its various debtors for extras performed by the corporation on contracts which the corporation had with its various debtors, principally the United States government and its various agencies. (R.T. pp. 43, 44, 52, 55, 56.) The evidence introduced at the trial further showed that the appellees believed that the assets of the corporation exceeded its liabilities. (Tr. pp. 26, 27.)

Counsel for appellant has seen fit to quote from Collier on Bankruptcy in support of his argument that the appellees had reasonable cause to believe that the debtor was insolvent. A sufficient answer to this contention is found in Collier's work on Bankruptcy at page 997, where it is said:

> "Apprehension or suspicion on the part of the creditor is not sufficient to constitute the 'reasonable cause to believe' which is required by #60 B of the Act. Reasonable cause to suspect is not always the equivalent of reasonable cause to believe".

and at page 1001:

> "It is difficult to formulate any well defined rules to determine the existence of a reasonable cause to believe that the debtor is insolvent. As indicated previously, whether or not a creditor receiving a preference has such reasonable cause to believe must ultimately be determined from the facts of each case. Consequently any controverted issue of fact is for the jury if the suit is at law, and where the evidence justifies a submission of the question, the finding of the jury is not reviewable. In every case there must be proof in the first instance that the debtor was actually insolvent at the time of the transfer and that the other elements of a preference are present, as well as proof of reasonable cause to believe on the part of the creditor or his agent acting with reference thereto, unless, of course, certain issues stand admitted by the pleadings or the pre-trial conference. In the absence of any requisite proof of reasonable cause to believe, the good faith of a creditor who receives a payment of his debt is

presumed; and the burden of proof rests with the trustee to rebut such a presumption and establish all the requisite elements plus reasonable cause to believe in the debtor's insolvency".

It has been held that reasonable cause for belief of insolvency is a question of fact and that the burden of proof is upon the trustee. In the case of *Marshall v. Nevins,* 242 Fed. 476 (9th C.C.A.) it was held at page 478:

"We are of the opinion that, while the circumstances might have led to the conclusion that Mrs. Nevins had reasonable cause to believe that the transfer by Hickman to her would effect a preference, and was intended to effect a preference, still whether such reasonable cause for belief existed was a question of fact with the burden of proof upon the trustee. The Supreme Court, in Pyle v. Texan Transport and Terminal Co., 238 U.S. 90; 35 Sup. Ct. 667; 59 L. Ed. 1215 has very recently said:

"By the statute's very words, in order to set aside such a transfer and recover the property, it must appear that the person receiving it, or to be benefited thereby, or his agent acting therein, shall have had reasonable cause to believe that it was thereby intended to give a preference. Whether such reasonable cause to believe existed is a question of fact, and the burden of proof is upon the trustee. Grant v. National Bank, 97 U.S. 80; 24 L. Ed. 971; Barbour v. Priest, 103 U.S. 293; 26 L. Ed. 478; Coder v. Arts, 213 U.S. 223; 29 Sup. Ct. 436; 53 L. Ed. 777; 16 Ann. Cas. 1008; Wright v. Sampter (D.C.) 152 Fed. 196.

". . . The advantage of having heard and seen the witness must have aided greatly in turning the case one way or the other."

In *Lang v. First Nat. Bank of Houston,* 215 F.2d 118, the Circuit Court upheld a finding made by the trial Court that a bank which had loaned money to the soon to be bankrupt and which subsequently took an assignment of accounts receivable to secure the payment of its note was not chargeable with having received a preference where the company went into bankruptcy within four months after the assignment of the accounts receivable. It is interesting to note that the bankrupt in the *Lange* case was a contractor whose principal dealings were with the Atomic Energy Commission, and agency of the United States government. The Circuit Court in upholding the judgment said:

"The past relationships between the appellee and the bankrupt had been successful, and we think that it was not unreasonable for the bank officers to take into consideration the nature of the business in which the bankrupt was engaged. It is well known in the business world that at a given time a large contractor may be insolvent in the sense that he owes more money than he has liquid assets; yet this is not necessarily insolvency in the legal sense. Rather it is only a shortage of cash or working capital, a situation which in the ordinary course of events can and will be remedied upon the completion of the contracts and the receipt of payment. His principal assets are not physical property such as real estate, equipment or inventory, but incorporeal

rights potentially of great value even though not readily turned into cash.

"To be sure, the Appellee knew that the bankrupt was having difficulty meeting current obligations—which, after all, was the reason working capital was needed. But it also knew that the bankrupt had several lucrative jobs in progress and that some were near completion. The past experiences with the bankrupt were such that the Appellee bank could reasonably expect payment of the loans, and the fact that a loan of $100,000.00 was made after the December 22 loan was past due is indicative of the confidence its officers had in the bankrupt's position. The slowness with which the bankrupt was meeting some obligations and the fact that it failed to pay the note due on January 21 were circumstances which would cause some inquiry to be made; and one was begun. The bankrupt showed the Appellee's officer that there were more than a half-million dollars in retainages on one job alone, explaining that receipt of this amount would remedy the situation considerably.

"We think that this explanation was reasonable, and that under all the circumstances the Appellee was justified in not making inquiry into the legal solvency of the bankrupt. This being true, there is nothing in the record to require a finding that the payment of February 8 was anything more than a routine transaction similar to other payments made during the preceding year.

CONCLUSION.

It is respectfully submitted that the findings of fact made by the trial Court were supported by substantial evidence and that the judgment of the trial Court should therefore be sustained.

Dated, San Francisco, California,
February 18, 1957.

ALFRED M. MILLER,
Attorney for Appellees.